

**STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC**

*Material for  
Staff Presentation to the  
Federal Open Market Committee*

*July 2, 1990*

## **Basic Assumptions**

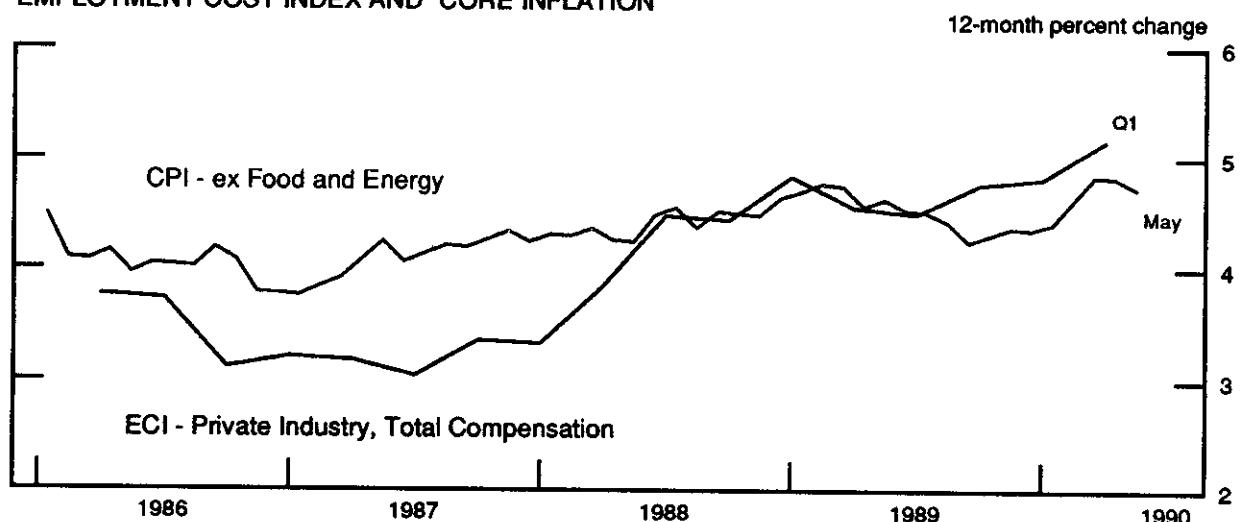
- Monetary policy aimed at a slowing of inflation over time, in the context of sustained economic expansion.
- Fiscal policy is moderately restrictive.
- Shift in credit supply conditions has occurred, but it is of small proportions and its effects diminish in the coming year.

## **Key Financial Variables**

- Interest rates remain near recent levels.
- Money growth continues to be retarded by thrift resolutions and capital constraints.
  - M2 increases about 3-1/2 percent in 1990 and 4-1/2 percent in 1991
  - M3 increases about 1 percent in 1990 and 1-1/2 percent in 1991
- Debt aggregate expands around 7 percent in 1990 and 6-1/2 percent in 1991.
- Dollar essentially stable.

Chart 2

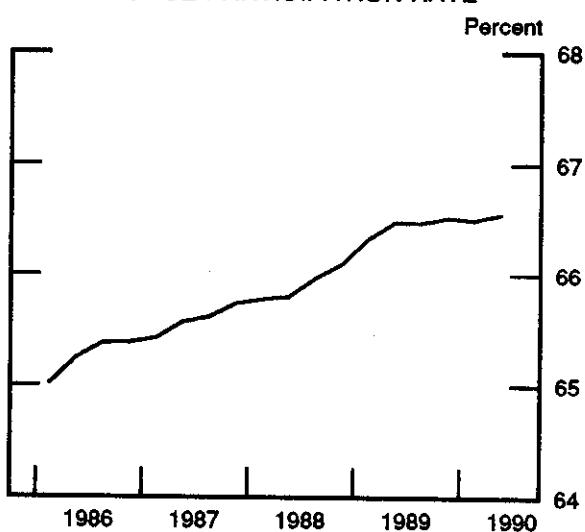
## EMPLOYMENT COST INDEX AND "CORE INFLATION"



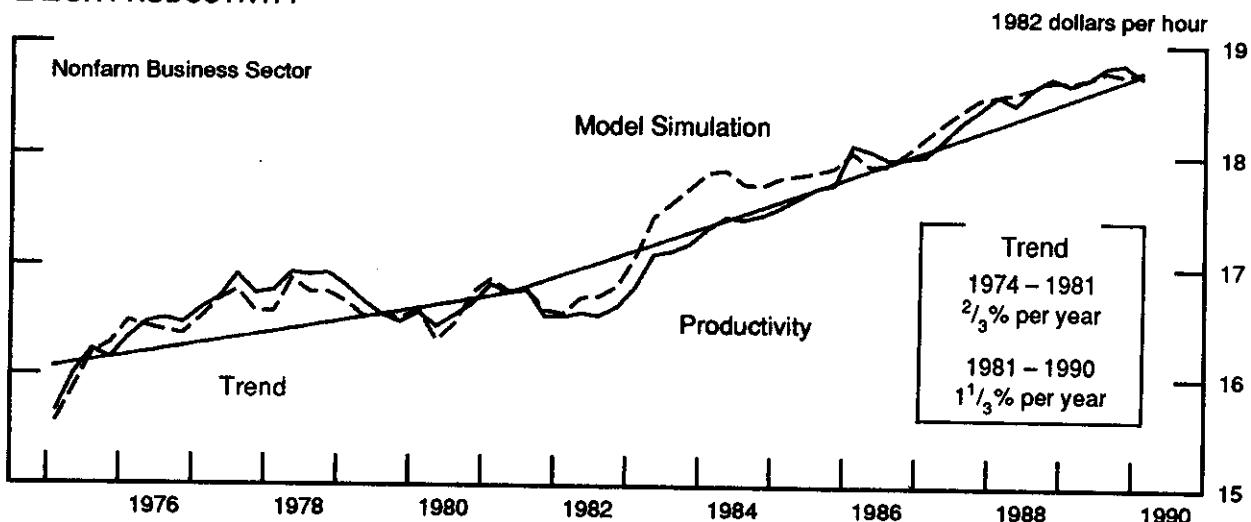
## LABOR FORCE GROWTH



## LABOR FORCE PARTICIPATION RATE



## LABOR PRODUCTIVITY



**ECONOMIC PROJECTIONS FOR 1990**

<b>FOMC</b>				
	<b>Range</b>	<b>Central Tendency</b>	<b>Administration *</b>	<b>Staff</b>
----- <i>Percent change, Q4 to Q4</i> -----				
Nominal GNP	5 to 6-1/2	5-1/2 to 6-1/2	6.7	6.0
<i>previous estimate</i>	4 to 7	5-1/2 to 6-1/2	7.0	5.7
Real GNP	1 to 2	1-1/2 to 2	2.2	1.8
<i>previous estimate</i>	1 to 2-1/4	1-3/4 to 2	2.6	1.6
CPI	4 to 5	4-1/2 to 5	4.8	4.8
<i>previous estimate</i>	3-1/2 to 5	4 to 4-1/2	4.1	4.4
----- <i>Average level, Q4, percent</i> -----				
Unemployment Rate	5-1/2 to 6-1/2	5-1/2 to 5-3/4	5.4	5.8
<i>previous estimate</i>	5-1/2 to 6-1/2	5-1/2 to 5-3/4	5.4	5.9

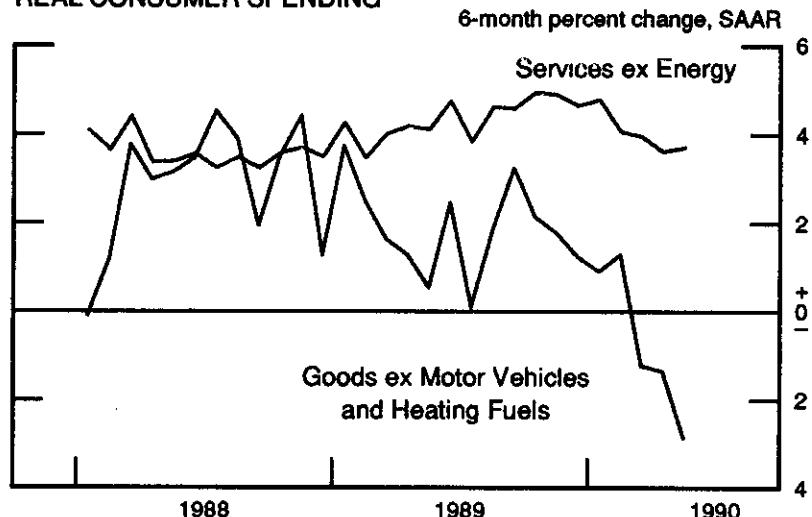
**ECONOMIC PROJECTIONS FOR 1991**

<b>FOMC</b>				
	<b>Range</b>	<b>Central Tendency</b>	<b>Administration *</b>	<b>Staff</b>
----- <i>Percent change, Q4 to Q4</i> -----				
Nominal GNP	3-1/2 to 7	5-1/4 to 6-1/2	7.1	6.4
Real GNP	0 to 3	1-3/4 to 2-1/2	2.9	2.2
CPI	3-1/2 to 5	3-3/4 to 4-1/2	4.2	4.5
----- <i>Average level, Q4, percent</i> -----				
Unemployment Rate	5-1/4 to 7	5-1/2 to 6	5.6	6.1

\* Administration forecasts are not yet officially released. Nominal GNP and unemployment rates partially estimated by Board staff.

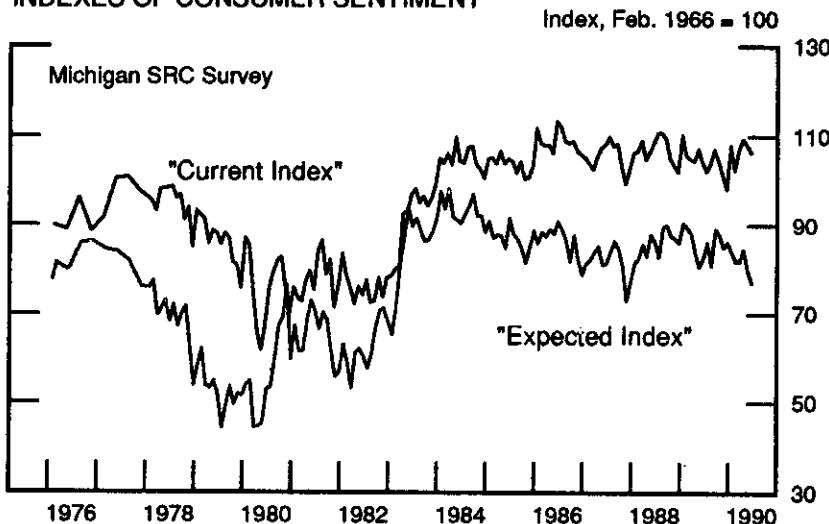
Chart 4

## REAL CONSUMER SPENDING

Income and Spending  
Percent change, SAAR

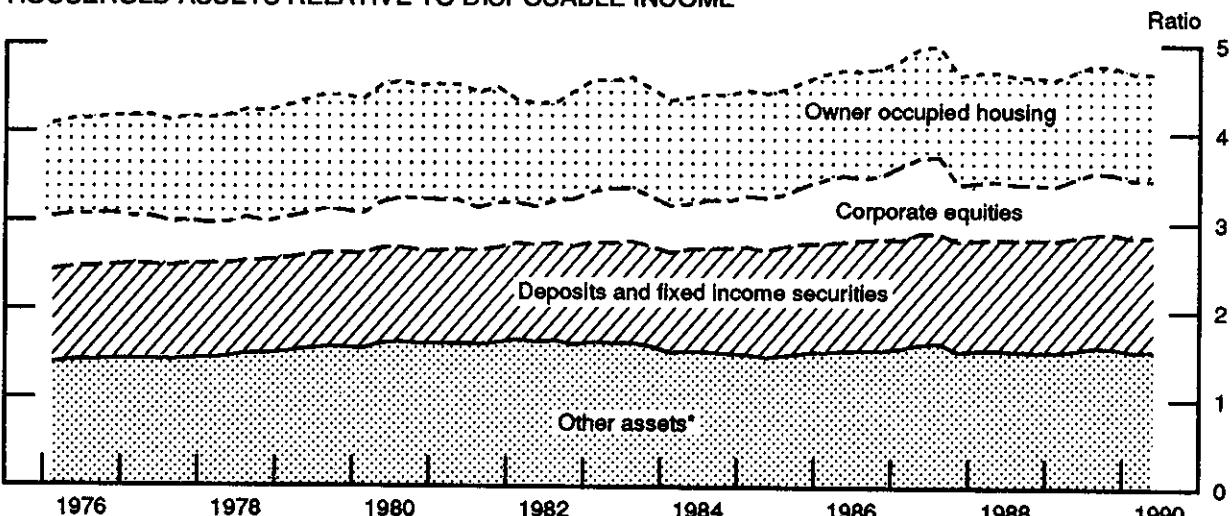
	Real PCE	Real DPI
1988	3.8	4.0
1989	2.5	3.6
1990 H1	1.1	2.1
H2	1.9	.8
1991 H1	1.8	1.6
H2	2.1	1.6

## INDEXES OF CONSUMER SENTIMENT



	Sentiment Index	
	1988 Q2	1990 Q2
Northeast	97	80
North central	94	95
South	92	91
West	94	98

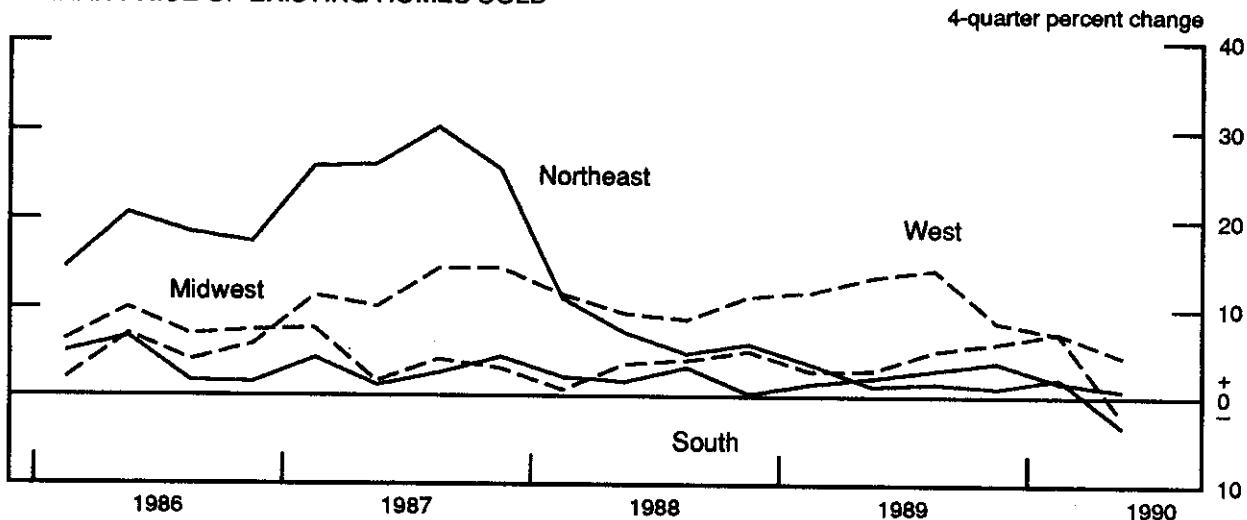
## HOUSEHOLD ASSETS RELATIVE TO DISPOSABLE INCOME



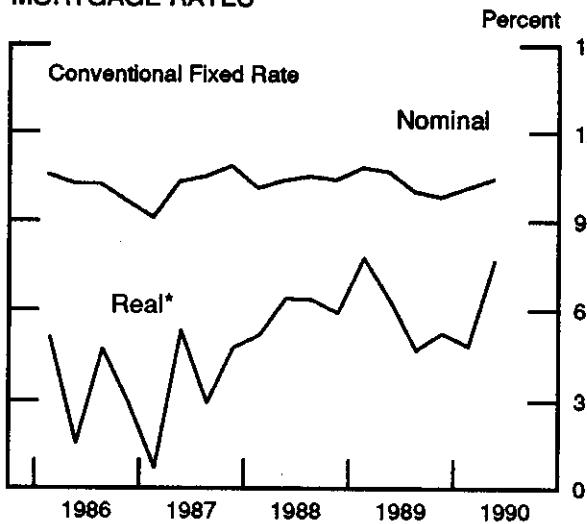
\* Principally life insurance and pension fund reserves, and equity in noncorporate business.

Chart 5

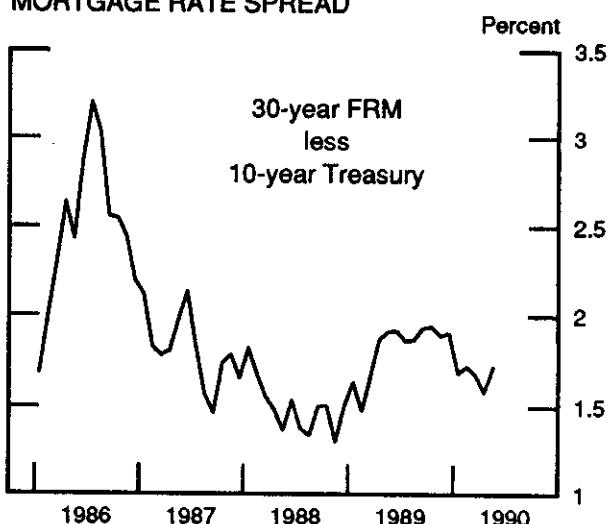
## MEDIAN PRICE OF EXISTING HOMES SOLD



## MORTGAGE RATES



## MORTGAGE RATE SPREAD



\* Based on 12-month change in existing home prices.

## HOUSING STARTS

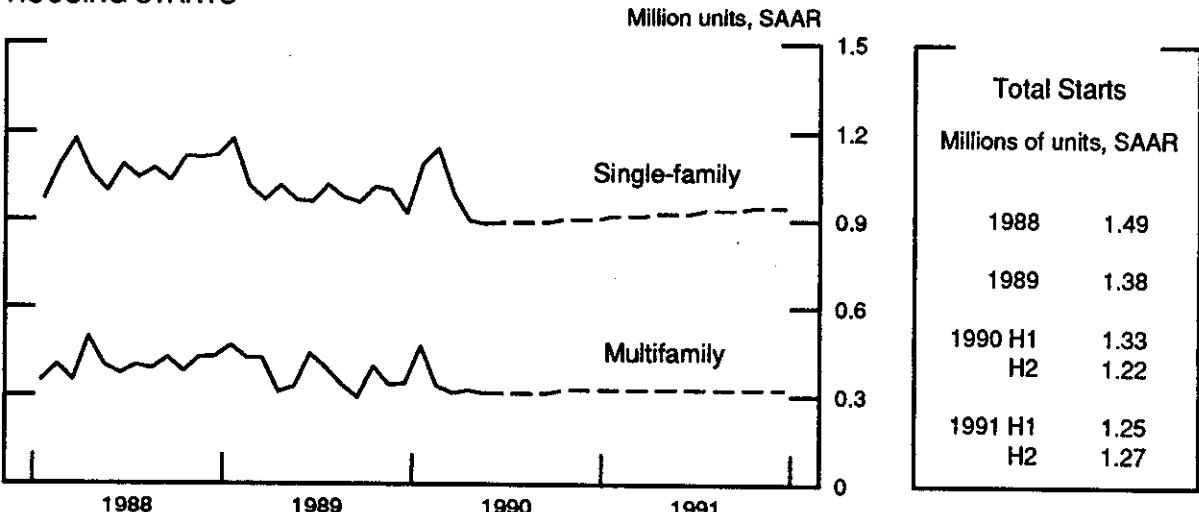
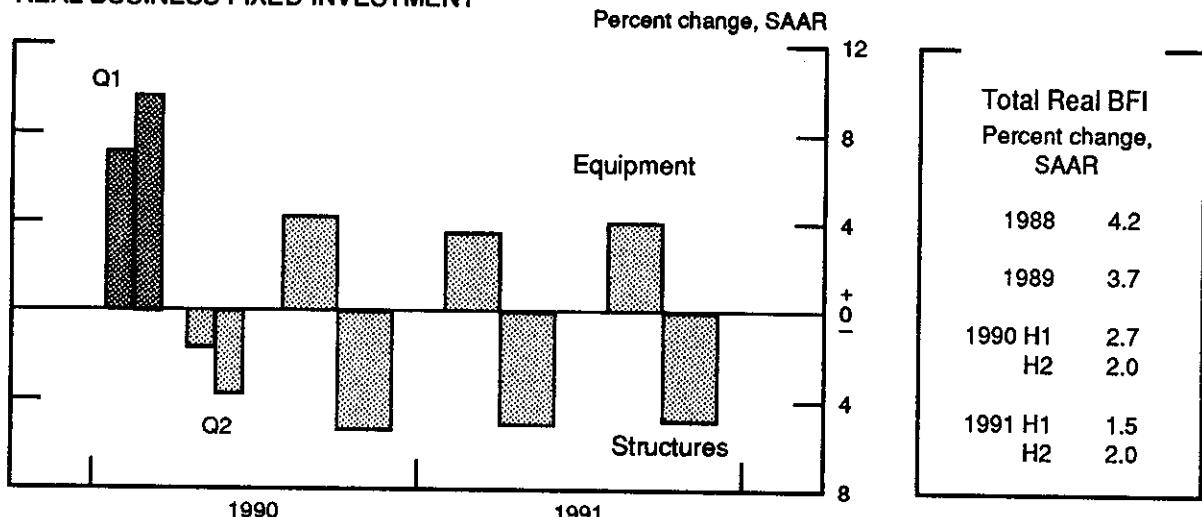
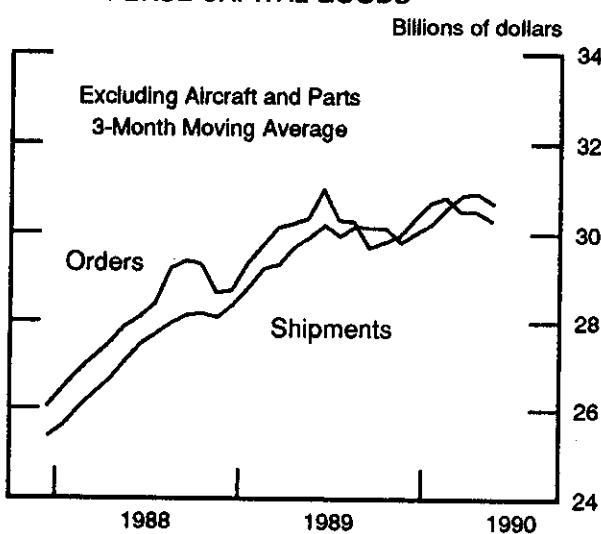


Chart 6

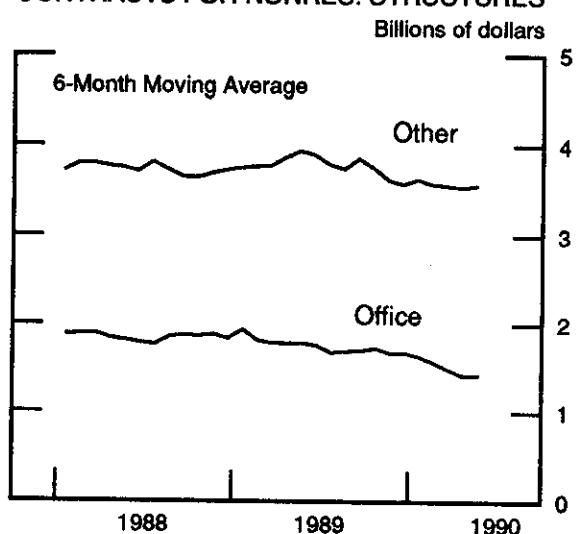
## REAL BUSINESS FIXED INVESTMENT



## NONDEFENSE CAPITAL GOODS



## CONTRACTS FOR NONRES. STRUCTURES



## PRE-TAX ECONOMIC PROFITS AND CASHFLOW

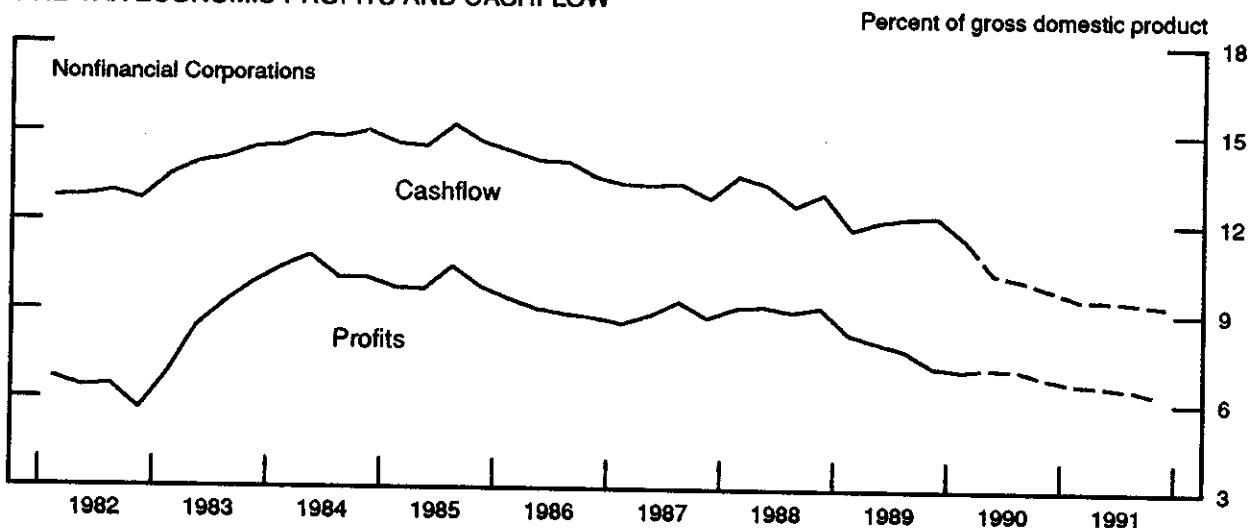
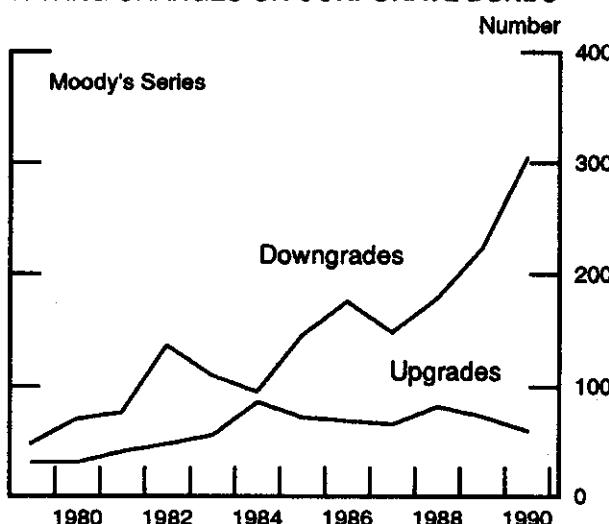


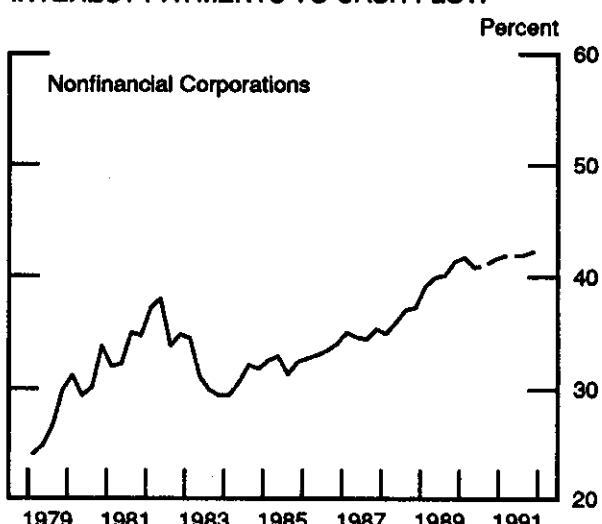
Chart 7

## RATING CHANGES ON CORPORATE BONDS



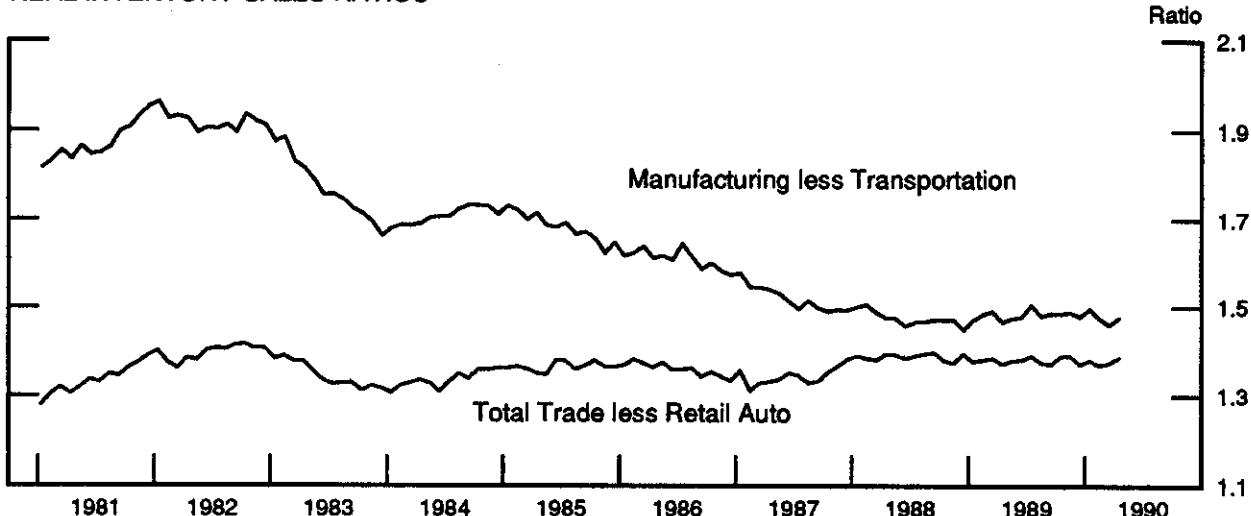
1990 observation is changes through May, at an annual rate.

## INTEREST PAYMENTS TO CASH FLOW\*

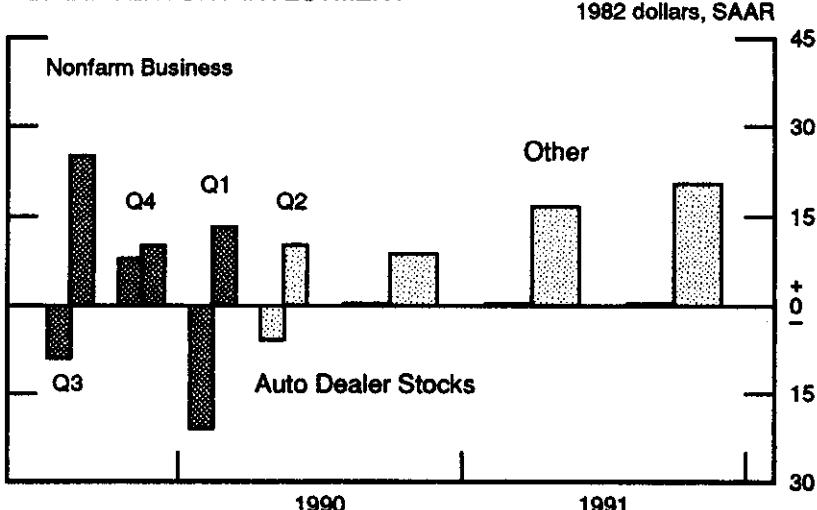


\* Gross interest to cash flow including interest payments.

## REAL INVENTORY-SALES RATIOS



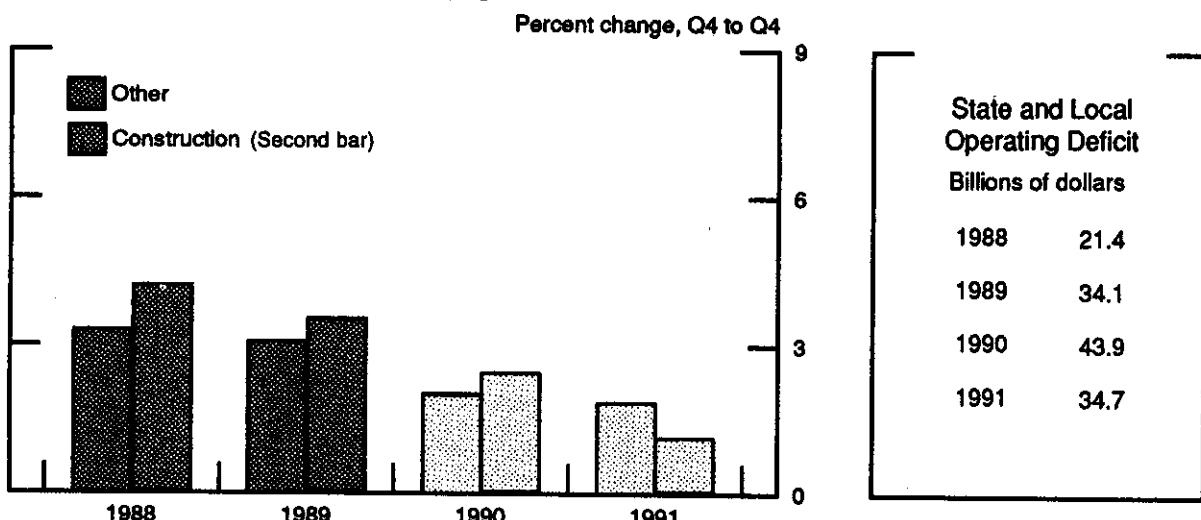
## REAL INVENTORY INVESTMENT



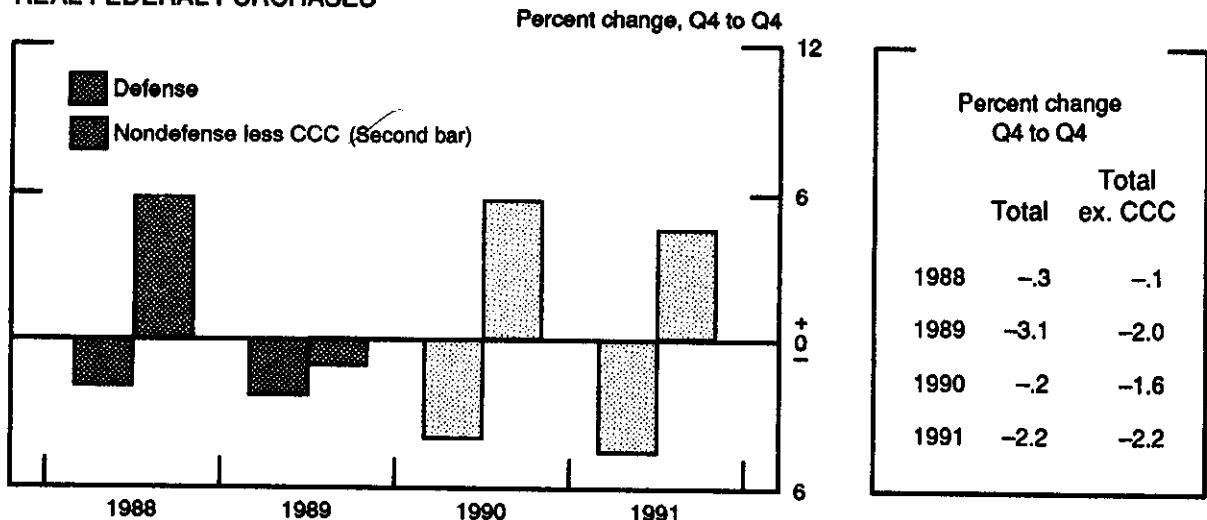
Nonfarm Inventory Investment	
	1982 dollars, SAAR
1989 Q3	16.2
Q4	18.0
1990 Q1	-7.8
Q2	4.4
H2	9.2
1991 H1	16.6
H2	20.6

Chart 8

## REAL STATE AND LOCAL PURCHASES



## REAL FEDERAL PURCHASES



## FEDERAL BUDGET OUTLOOK

BUDGET PROJECTION (\$ Billions)		1991 DEFICIT REDUCTION (\$ Billions)		
	FY1990	FY1991		
Receipts	1,043	1,132	Total Reduction	35
Outlays	1,260	1,318	Added Revenues	13
Deficit	217	186	Corp. and Ind. Income	10
Deficit ex RTC	157	116	Excise	3
			Outlay Cuts	22
			Defense	10
			Other	12

## Alternative Fiscal Scenarios

- All scenarios assume deficit-reduction packages of \$70 billion in FY1991 and FY1992--twice the reductions in the Greenbook.
- For FY1991, added reductions take form of 15¢ hike in gas tax, \$19 billion in expenditure cuts.
- For FY1992, added reductions take form of \$16 billion in personal income tax hikes, plus miscellaneous outlay cuts.

### INTEREST RATES HELD TO BASELINE PATH

	Deviation from Baseline		
	1990	1991	1992
Real GNP (percent change, Q4 to Q4)	-.2	-1.8	-1.9
Unemployment (percent, Q4)	.1	.7	1.6
GNP prices (percent change, Q4 to Q4)	.3	-.1	-1.0

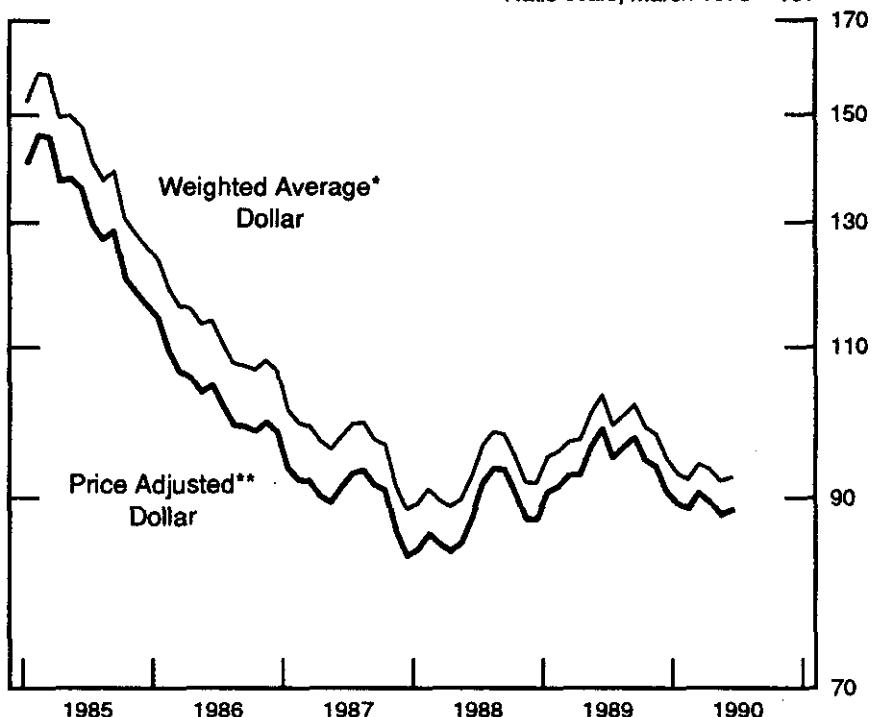
### INTEREST RATES ADJUSTED, STARTING IN 1990Q4, TO KEEP OUTPUT CLOSE TO BASELINE PATH

	Deviation from Baseline		
	1990	1991	1992
Federal funds rate (Q4, basis points)			
Without "credibility" <sup>1</sup>	-200	-140	-120
With "credibility"	-90	-75	-75
Bond rate (Q4, basis points)			
Without "credibility"	-30	-65	-80
With "credibility"	-65	-75	-75
GNP prices (percent change, Q4 to Q4)			
Without "credibility"	.3	.3	.3
With "credibility"	.3	.3	.3

1. "Credibility" effect: bond market anticipates lower deficits in future.

Chart 10

**FOREIGN EXCHANGE VALUE OF THE U.S. DOLLAR**  
 Ratio scale, March 1973 = 100

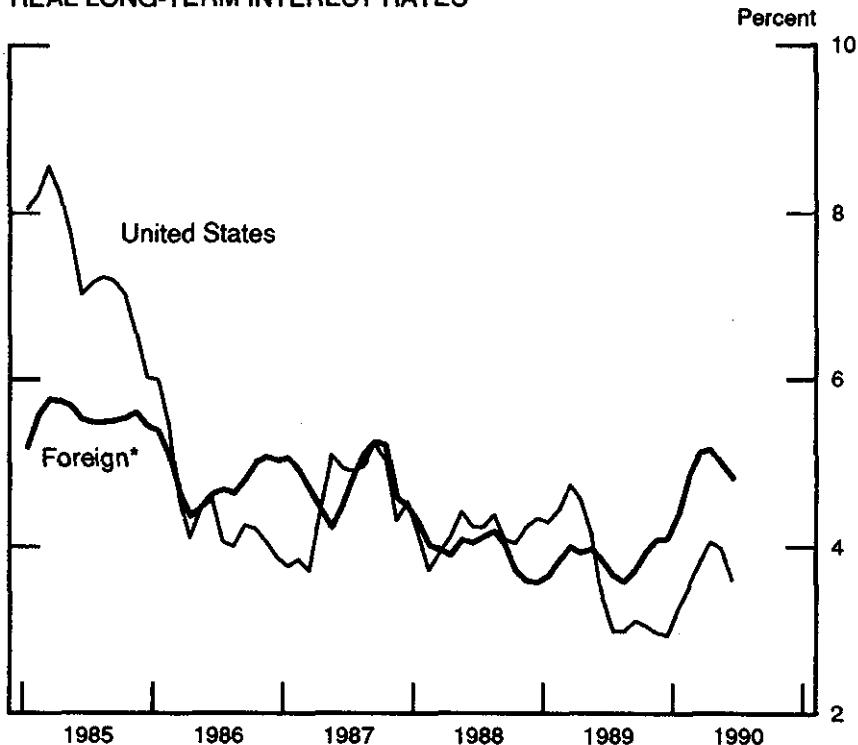


**Nominal Dollar Exchange Rates**

Percent change  
12/89 to 6/29/90

Pound sterling	-9
Deutschmark	-4
Canadian dollar	0
Yen	6
S. Korean won	6
Taiwan dollar	4

**REAL LONG-TERM INTEREST RATES\*\*\***



**Nominal Interest Rates**

Percent

Dec. 1989      June 29, 1990

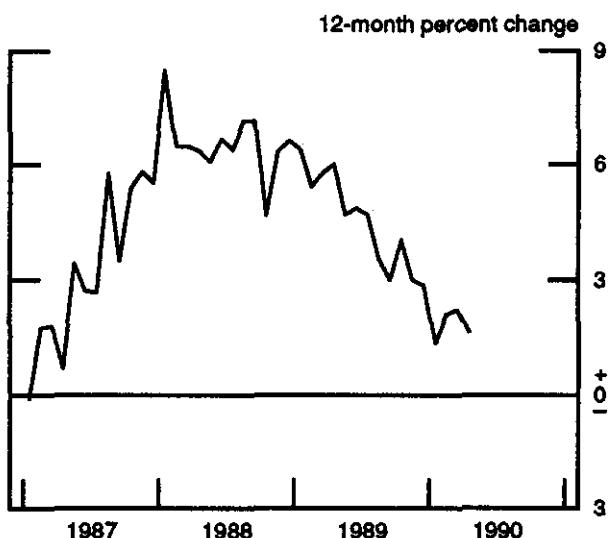
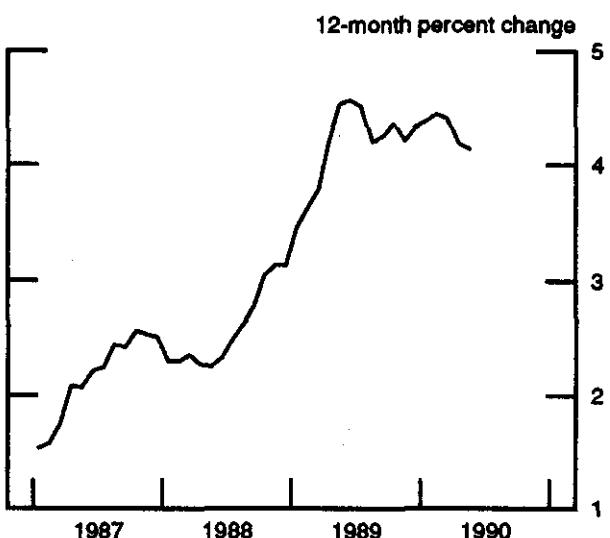
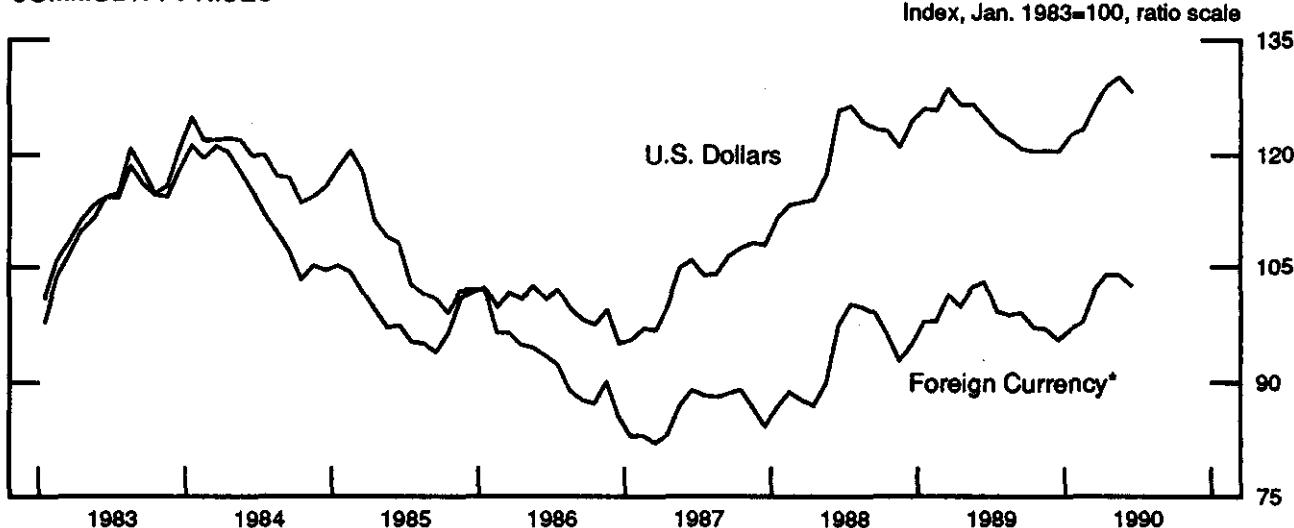
	Three-month	Long-term
Germany	8.06	7.18
Japan	6.93	5.61
U.S.	8.32	7.84
Germany	8.15	8.71
Japan	7.64	7.34
U.S.	8.15	8.43

\* Weighted average against or of foreign G-10 countries using total 1972-76 average trade.

\*\* Adjusted by relative consumer prices.

\*\*\* Multilateral trade-weighted average of long-term government or public authority bond rates adjusted or expected inflation estimated by a 36-month centered moving average or actual inflation (staff forecasts where needed).

Chart 11

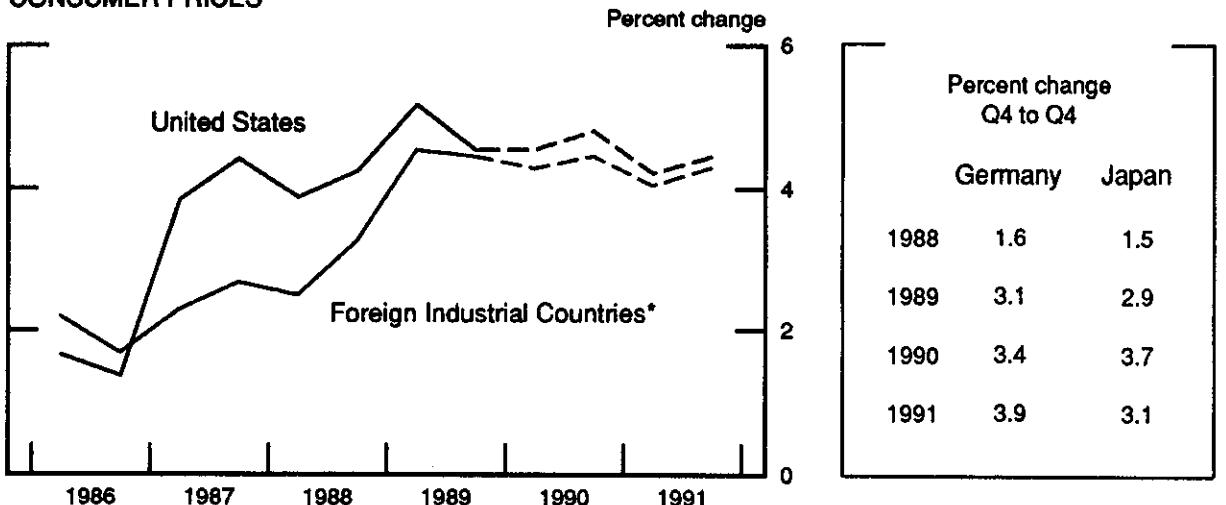
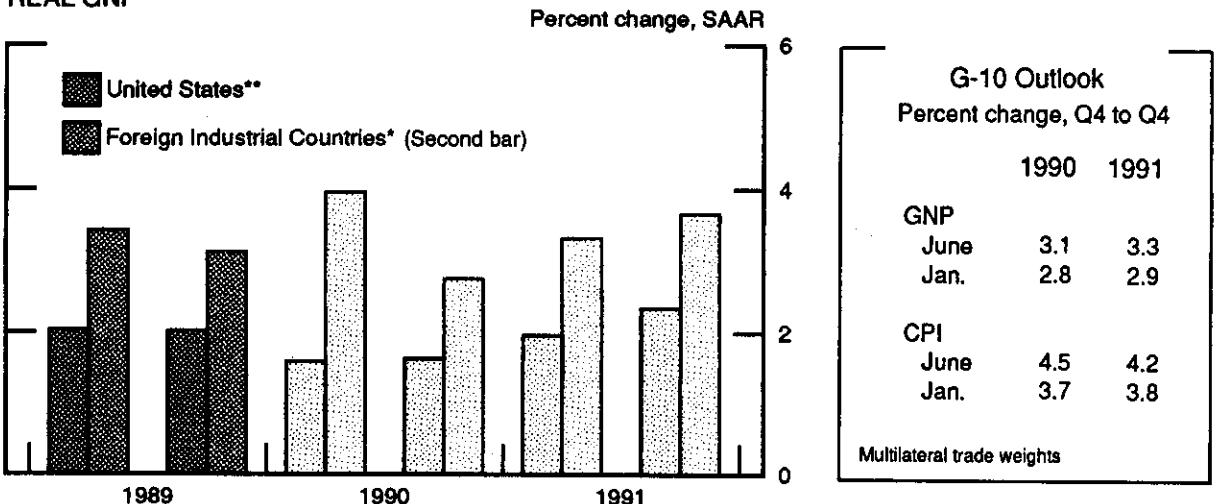
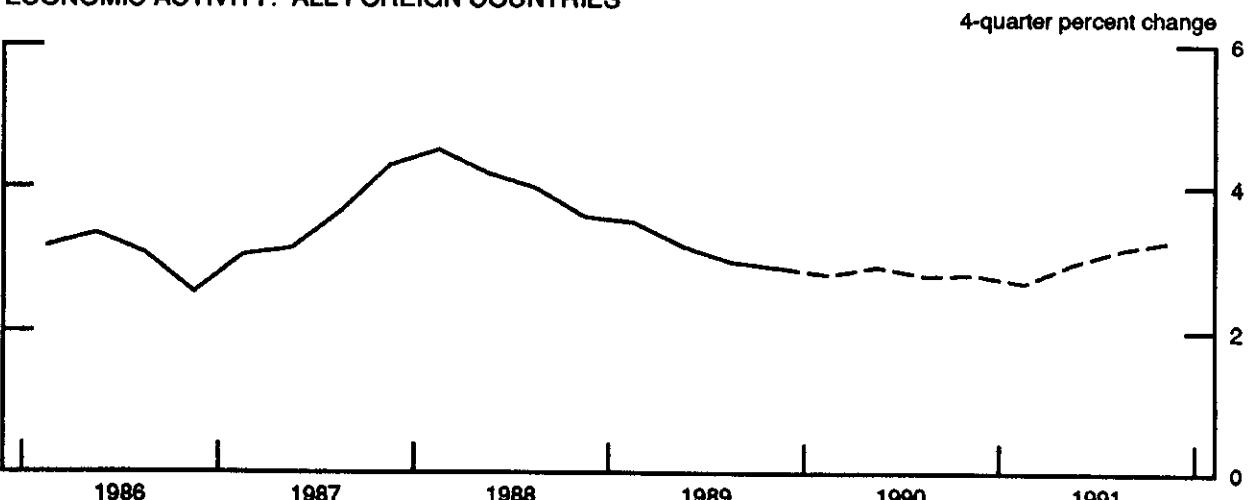
**INDUSTRIAL PRODUCTION ABROAD\*****CONSUMER PRICES ABROAD\*****COMMODITY PRICES\*\*****ECONOMIC POLICY ABROAD**

- Inflation has slowed, but concerns about wage and capacity pressures remain.
- Monetary policies cautious; further increases in German short-term interest rates expected; scope for some declines in interest rates as inflation eases.
- Fiscal policy essentially neutral in most countries except Germany.

\* Weighted average for the six major foreign industrial countries using 1982 GNP.

\*\* Federal Reserve Board experimental index excluding oil.

Chart 12

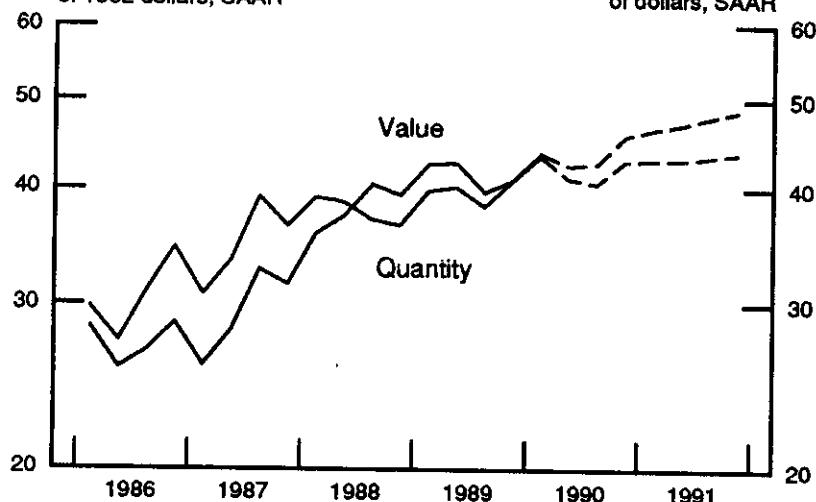
**CONSUMER PRICES****REAL GNP****ECONOMIC ACTIVITY: ALL FOREIGN COUNTRIES\*\*\***

\* Weighted average for the six major foreign industrial countries using multilateral trade weights.

\*\* Excludes drought effects.

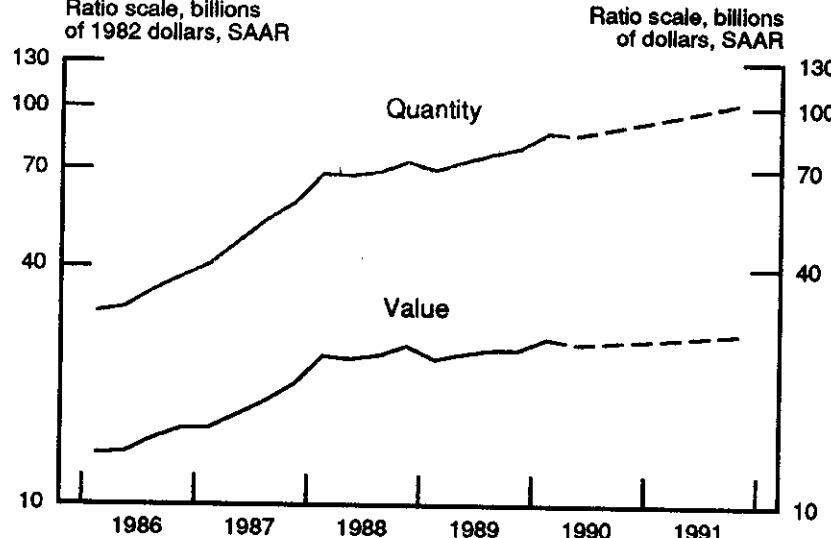
Chart 13

## Exports

**AGRICULTURAL EXPORTS**Ratio scale, billions  
of 1982 dollars, SAARPercent change  
Q4 to Q4

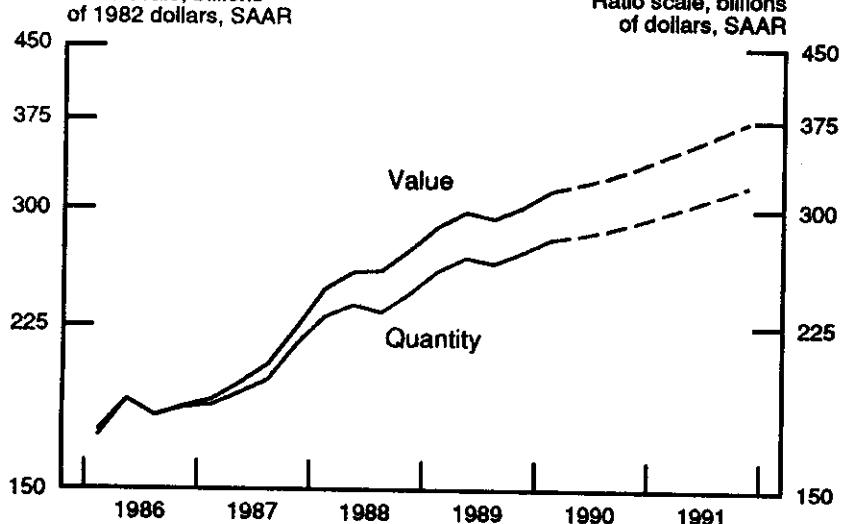
1989 1990 1991

Value	4	12	6
Price	-7	6	4
1982\$	12	5	2

**COMPUTER EXPORTS**Ratio scale, billions  
of 1982 dollars, SAARPercent change  
Q4 to Q4

1989 1990 1991

Value	-2	5	5
Price	-10	-8	-8
1982\$	8	14	14

**OTHER NON-AGRICULTURAL EXPORTS**Ratio scale, billions  
of 1982 dollars, SAARPercent change  
Q4 to Q4

1989 1990 1991

Value	11	10	12
Price	0	3	3
1982\$	11	8	10

Chart 14

## Non-oil Imports

## PRICES

	Percent change, Q1 to Q1	
	1989	1990
1. Food	1	-4
2. Industrial Supplies	10	-3
3. Computers	-4	-9
4. Other Capital Goods	3	1
5. Automotive	4	1
6. Consumer Goods	3	2
7. Other	5	0
<b>8. Total Non-oil</b>	<b>5</b>	<b>0</b>

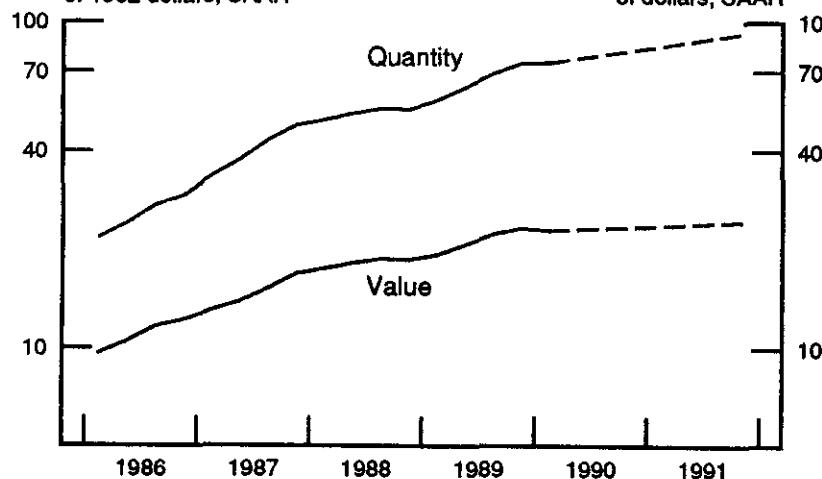
NIPA fixed-weight indexes

## QUANTITIES

	Percent change, Q1 to Q1	
	1989	1990
1. Food	-4	16
2. Industrial Supplies	-3	0
3. Computers	14	31
4. Other Capital Goods	12	15
5. Automotive	1	-8
6. Consumer Goods	1	3
7. Other	2	22
<b>8. Total Non-oil</b>	<b>3</b>	<b>6</b>

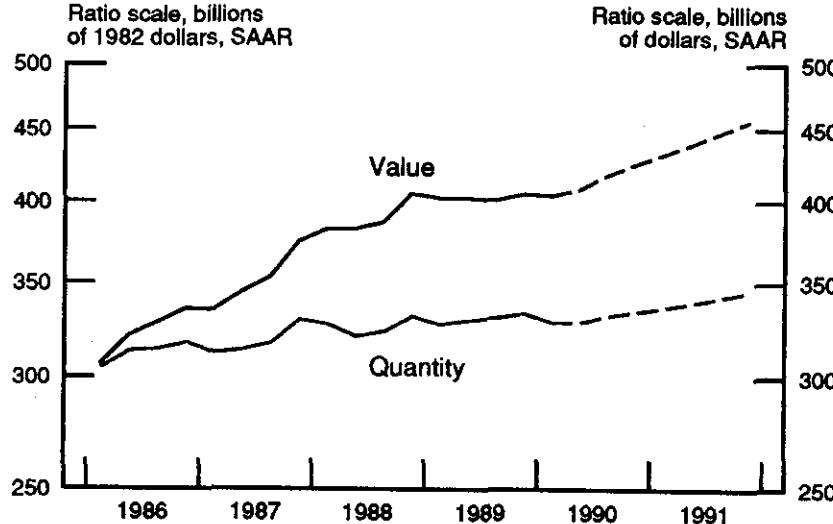
NIPA accounts

## COMPUTER IMPORTS

Ratio scale, billions  
of 1982 dollars, SAARRatio scale, billions  
of dollars, SAARPercent change  
Q4 to Q4

	1989	1990	1991
Value	25	1	4
Price	-10	-8	-8
1982\$	39	10	13

## OTHER NON-OIL IMPORTS

Ratio scale, billions  
of 1982 dollars, SAARRatio scale, billions  
of dollars, SAARPercent change  
Q4 to Q4

	1989	1990	1991
Value	0	5	7
Price	-1/2	5	4
1982\$	1/2	0	3

Chart 15

## Petroleum and Products

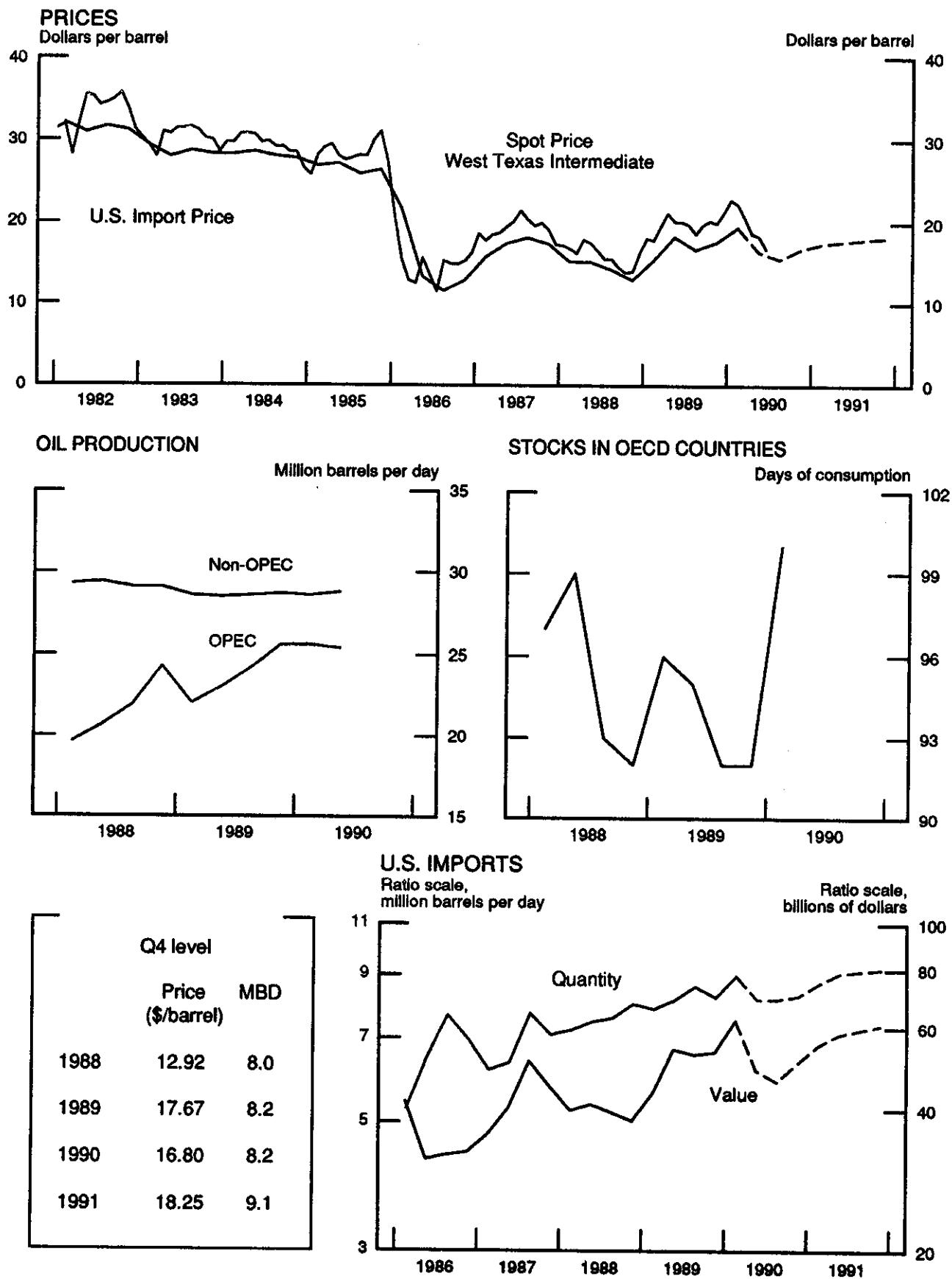
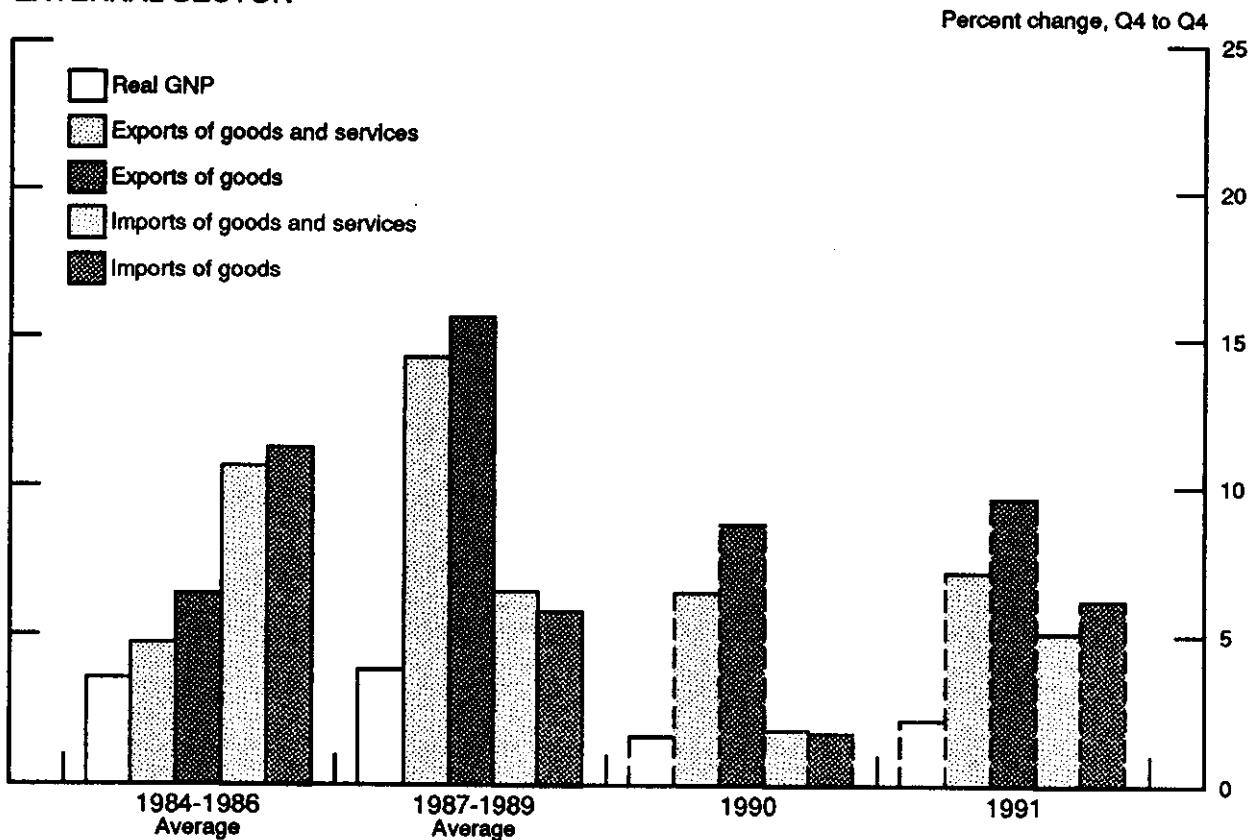


Chart 16

## U.S. External Accounts

## EXTERNAL SECTOR



## EXTERNAL BALANCES

Billions of 1982 dollars, SAAR

Billions of dollars, SAAR

